

REPORT OF EXAMINATION
OF THE
PACIFIC PROPERTY AND CASUALTY COMPANY
AS OF
DECEMBER 31, 2005

Filed May 24, 2007

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Los Angeles, California
April 2, 2007

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PACIFIC PROPERTY AND CASUALTY COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 1949 E. Sunshine, Springfield, Missouri 65899. The Company's statutory home office and main administrative office is located at 5401 Business Park South, Suite 119, Bakersfield, California 93330.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; loss experience; business in force by states; and sales and advertising.

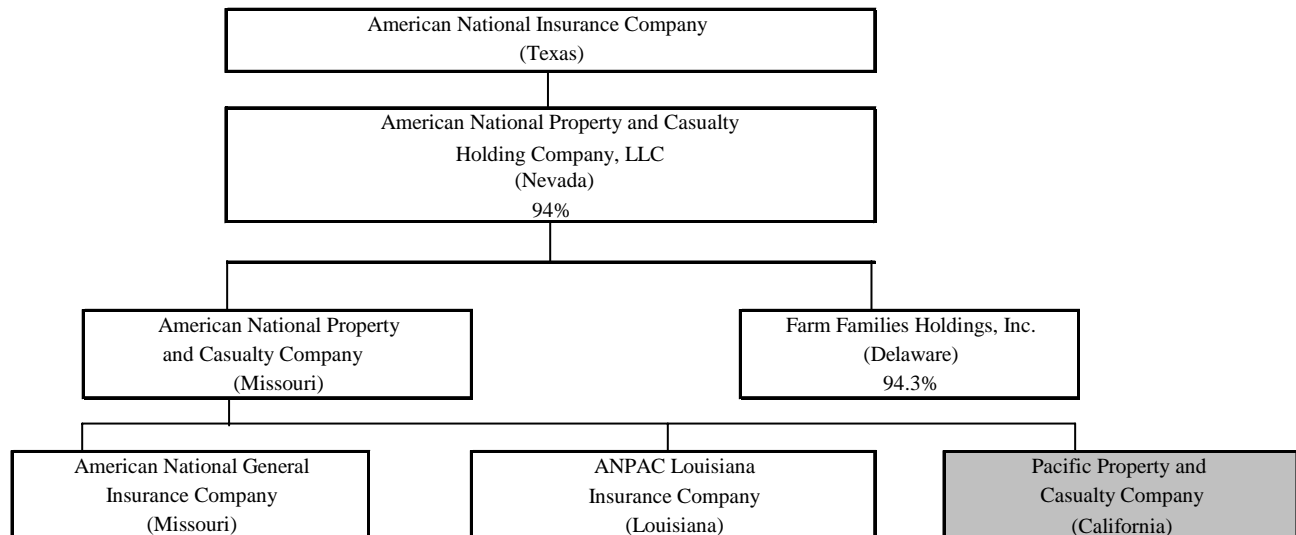
COMPANY HISTORY

The Company was incorporated in California on December 28, 1995 as a wholly-owned subsidiary of American National Property and Casualty Company for the purpose of writing California property and casualty business. It commenced business on October 1, 2000.

Effective May 21, 2003, the Company amended its Articles of Incorporation to increase its \$100 par value capital stock to \$104. This amendment was filed with the California Department of Insurance and approved on May 27, 2003. The gross paid-in and contributed surplus account was reduced from \$7.5 million to \$7.4 million, and common capital stock was increased from \$2.5 million to \$2.6 million.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



(*) all ownership is 100% unless otherwise noted

Management of the Company is vested in a nine-member board of directors elected annually. A listing of the members of the board and principal officers serving as of December 31, 2005 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Charles Henry Addison Galveston, Texas	Senior Vice President, System Planning and Computing American National Insurance Company
Robert Joseph Campbell Springfield, Missouri	Senior Vice President, General Counsel and Secretary American National Property and Casualty Company
George Richard Ferdinandtsen Galveston, Texas	President and Chief Operating Officer American National Insurance Company
Irwin Mark Herz Jr. Galveston, Texas	Attorney Greer, Herz and Adams, LLP
Ross Rankin Moody Galveston, Texas	Director National Western Life Insurance Company
Gregory Victor Ostergren Galveston, Texas	Executive Vice President, Multiple Line Marketing American National Insurance Company
Stephen Edward Pavlicek Galveston, Texas	Senior Vice President and Controller American National Insurance Company
James Edward Pozzi Galveston, Texas	Senior Executive Vice President, Corporate Planning American National Insurance Company
Ronald Jay Welch Galveston, Texas	Chief Actuary and Chief Corporate Risk Management Officer American National Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Gregory Victor Ostergren	Chairman, President and Chief Executive Officer
Robert Joseph Campbell	Senior Vice President, General Counsel and Secretary
James Michael Cybulski	Vice President, Controller and Treasurer
Janet Anita Clark	Vice President, Underwriting Services
Bernard Stephen Gerwel	Senior Vice President, Marketing Information and Tech Services
Jerry Wayne Jones	Vice President, Claims Services
Edward Joseph Messerly	Vice President, Information and General Services
Michael Wade McCroskey	Vice President, Investments
Ronald Eugene Rathburn	Underwriting Compliance Officer
Byron Whitaker Smith	Vice President, Actuarial Services

Management Agreements

Services Agreement: The Company and all of its insurance affiliates are parties to a Services Agreement with its parent, American National Property and Casualty Company (ANPAC). Under the terms of the agreement, the Company receives certain managerial, accounting and data processing services from ANPAC. The agreement specifies that reimbursement for accounting services is based on the actual cost and reimbursement for all other facilities and services will be on a cost allocation basis. The agreement has been in force since January 31, 1996. For 2003, 2004, and 2005, the fees paid by the Company were \$602,740, \$3,553,226, and \$3,577,803, respectively. This agreement was approved by the California Department of Insurance (CDI) on September 27, 2005.

Tax Sharing Agreement: The Company is a member of the American National Insurance Company Consolidated Tax Sharing Agreement, effective January 1, 1996, and amended January 1, 1998. For purposes of calculating the earnings and profits of each of the members, the consolidated federal income tax liability of the affiliated group is apportioned among the members in accordance with the method set forth in the Internal Revenue Code. This agreement

was not filed with the CDI pursuant to California Insurance Code Section 1215.5(b)(4). It is recommended that the Company file the tax sharing agreement with the CDI for approval.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed to transact multiple lines of property and casualty insurance in California. In 2005, the Company wrote \$23.8 million of direct premiums. The principal lines of business written were private passenger auto liability, \$9.41 million or 39.6%, auto physical damage, \$6.79 million or 28.6%, homeowners multiple peril, \$6.02 million or 25.3%, and allied lines, \$1.03 million or 4.2%. The remainder of the direct premiums written totaled \$542,226 or 2.3%, and was composed of products liability, inland marine, and fire lines.

The Company markets its products through exclusive agents in California. As of December 31, 2005 the Company utilized the services of 89 agents located throughout California.

ACCOUNTS AND RECORDS

During the examination period the Company wrote earthquake insurance as a rider to its homeowners' policies. The Company reported this business as combined with its earthquake business in its Annual Statement. The combination of the earthquake line into the homeowners does not show the true risk exposure of the earthquake business. Due to the unique features of earthquake coverage and the risk presented, it is recommended that the Company segregate the premium of its earthquake riders from the homeowners' policies in its Annual Statement.

REINSURANCE

Assumed

The Company has no reinsurance assumed.

Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2005:

<u>Type of Contract</u>	<u>Reinsurer's Name</u>	<u>Company's Retention</u>	<u>Reinsurer's Maximum Limits</u>
Multiple Line Excess of Loss	American National Property and Casualty Company	\$500,000	\$500,000 xs \$500,000
First Multiple Line Excess of Loss	Dorinco Reinsurance Co (40%) Partner Reinsurance Co of the US (50%) Hannover Rueck (10%)	\$500,000	\$500,000 xs \$500,000 per risk, \$1,500,000 per occurrence
Second Multiple Line Excess of Loss	American Re-Insurance (Direct) (75%) Partner Reinsurance Co of the US (25%)	\$1 million	\$5 million xs \$1 million per risk; \$10 million per occurrence
Property Catastrophe First Excess	American National Property and Casualty Company	\$1 million each loss occurrence	97.5% of \$9 million xs \$1 million each loss occurrence
Property Catastrophe Second Excess	American National Property and Casualty Company	\$10 million each loss occurrence	97.5% of \$5 million xs \$10 million each loss occurrence
First Excess Casualty Clash	Hannover Rueck (50%) American Re-Insurance (Direct) (50%)	\$6 million	\$5 million xs \$6 million per occurrence
Second Excess Casualty Clash	Hannover Rueck (50%) Platinum Underwriters Reinsurance (25%) Lloyd's Syndicates (15%) QBE Reinsurance Corp (10%)	\$11 million	\$14 million xs \$11 million per occurrence
Third Excess Casualty Clash	Hannover Rueck (50%) Lloyds Syndicates (15%) Platinum Underwriters Reinsurance (15%) New Jersey Reinsurance Company (10%) QBE Reinsurance Corp (10%)	\$25 million	\$5 million xs \$25 million per occurrence

The Company, along with its affiliated property and casualty companies, participates in additional reinsurance agreements. The group has property catastrophe excess loss coverage where it retains \$15 million on catastrophe losses with various layers providing coverage up to \$170 million. In addition to this coverage, the group participates with its affiliated property and casualty

companies in a stop loss contract with Lloyd's syndicates. The contract reinsures the group up to \$15 million for any amounts in excess of the group's retention of \$185 million.

As of December 31, 2005, net reinsurance recoverables, for all ceded reinsurance totaled \$1.2 million or 7.1% of surplus as regards policyholders. All of the ceded reinsurance recoverables were from affiliated admitted reinsurers.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

Statement of Financial Condition
as of December 31, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 27,596,936	\$	\$ 27,596,936	(1)
Stocks:				
Common stocks	2,928,820		2,928,820	
Cash and short-term investments	1,378,087		1,378,087	
Premiums and considerations:				
Deferred premiums, agents balances and installments booked but deferred and not yet due	3,157,204	20,111	3,137,093	
Current federal and foreign income tax recoverable and interest thereon	468,249		468,249	
Net deferred tax asset	706,509		706,509	
Guaranty funds receivable or on deposit	38		38	
Investment income due and accrued	356,779		356,779	
Receivable from parent, subsidiaries and affiliates	24,012		24,012	
Aggregate write-ins for other than invested assets	<u>41,501</u>	<u> </u>	<u>41,501</u>	
Total assets	<u>\$ 36,658,135</u>	<u>\$ 20,111</u>	<u>\$ 36,638,024</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 7,823,186	(2)
Loss adjustment expenses			2,607,708	(2)
Commissions payable, contingent commissions and other similar charges			516,769	
Other expenses			4,284	
Taxes licenses and fees			44,442	
Unearned premiums			8,029,529	
Advance premium			252,957	
Ceded reinsurance premiums payable			248,603	
Remittances and items not allocated			9,099	
Payable to parent, subsidiaries and affiliates			550,768	
Aggregate write-ins for liabilities			<u>26,369</u>	
Total liabilities			20,113,714	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		7,400,000		
Unassigned funds (surplus)		<u>6,524,310</u>		
Surplus as regards policyholders			<u>16,524,310</u>	
Total liabilities, surplus and other funds			<u>\$ 36,638,024</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

Premiums earned		\$ 21,593,225
Deductions:		
Losses incurred	\$ 11,757,987	
Loss expense incurred	2,147,313	
Other underwriting expenses incurred	<u>4,145,523</u>	
Total underwriting deductions		<u>18,050,823</u>
Net underwriting gain		3,524,402

Investment Income

Net investment income earned	\$ 1,117,446	
Net realized capital gains	<u>28,059</u>	
Net investment gain		1,145,505

Other Income

Net loss from agents' balances charged off	\$ (41,833)	
Finance and service charges not included in premiums	<u>45,995</u>	
Total other income		<u>4,162</u>
Net income before federal and foreign income taxes		4,692,069
Federal and foreign income taxes incurred		<u>1,501,862</u>
Net income		<u>\$ 3,190,207</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		\$ 13,195,576
Net income	\$ 3,190,207	
Change in net unrealized capital gains	32,323	
Change in net deferred income tax	93,457	
Change in nonadmitted assets	<u>12,747</u>	
Change in surplus as regards policyholders for the year		<u>3,328,734</u>
Surplus as regards policyholders, December 31, 2005		<u>\$ 16,524,310</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

Surplus as regards policyholders, December 31, 2002, per Examination			\$ 10,441,011
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 5,519,369	\$	
Change in net unrealized capital gains	250,846		
Change in deferred income tax	325,400		
Change in nonadmitted assets	<u> </u>	<u>12,316</u>	
Totals	<u>\$ 6,095,615</u>	<u>\$ 12,316</u>	
Net increase in surplus as regards policyholders for the examination			<u>6,083,299</u>
Surplus as regards policyholders, December 31, 2005, per Examination			<u>\$16,524,310</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Custodial Agreement

The Company has a custodial agreement with Wells Fargo Bank, NA. This custodian is not a qualified custodian as defined in California Insurance Code Section 1104.9. It is recommended that the Company execute a custodial agreement with a qualified custodian, and file the agreement with the California Department of Insurance (CDI) for approval.

(2) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the CDI, the Company's loss and loss adjustment expense reserves as of December 31, 2005 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Management Agreements – Tax Sharing Agreement (Page 4): It is recommended that the Company file the tax sharing agreement with the CDI for approval.

Accounts and Records (Page 5): It is recommended that the Company segregate the premium of its earthquake riders from the homeowners' policies in its Annual Statement.

Comments on Financial Statements – Custodial Agreement (Page 11): It is recommended that the Company execute a custodial agreement with a qualified custodian and file the agreement with the CDI for approval.

Previous Report of Examination

Management and Control – Service Agreement (Page 6): It was recommended that the Company file its amended service agreement with the CDI pursuant to California Insurance Code Section 1215.4. The amended service agreement was filed with the CDI on August 6, 2004, and approved on September 27, 2005.

Accounts and Records (Page 9): It was recommended that the Company record advance premiums in accordance with Statement of Statutory Accounting Principle (SSAP) Number 53, Paragraph 13. The Company has corrected the accounting treatment of its advance premiums.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination is hereby acknowledged.

Respectfully submitted,

/S/

Gint Prismantas, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California